

§ 1.672(a)-1 Definition of adverse party.

(a) Under section 672(a) an adverse party is defined as any person having a substantial beneficial interest in a trust which would be adversely affected by the exercise or nonexercise of a power which he possesses respecting the trust. A trustee is not an adverse party merely because of his interest as trustee. A person having a general power of appointment over the trust property is deemed to have a beneficial interest in the trust. An interest is a substantial interest if its value in relation to the total value of the property subject to the power is not insignificant.

(b) Ordinarily, a beneficiary will be an adverse party, but if his right to share in the income or corpus of a trust is limited to only a part, he may be an adverse party only as to that part. Thus, if A, B, C, and D are equal income beneficiaries of a trust and the grantor can revoke with A's consent, the grantor is treated as the owner of a portion which represents three-fourths of the trust; and items of income, deduction, and credit attributable to that portion are included in determining the tax of the grantor.

(c) The interest of an ordinary income beneficiary of a trust may or may not be adverse with respect to the exercise of a power over corpus. Thus, if the income of a trust is payable to A for life, with a power (which is not a general power of appointment) in A to appoint the corpus to the grantor either during his life or by will, A's interest is adverse to the return of the corpus to the grantor during A's life, but is not adverse to a return of the corpus after A's death. In other words, A's interest is adverse as to ordinary income but is not adverse as to income allocable to corpus. Therefore, assuming no other relevant facts exist, the grantor would not be taxable on the ordinary income of the trust under section 674, 676, or 677, but would be taxable under section 677 on income allocable to corpus (such as capital gains), since it may in the discretion of a nonadverse party be accumulated for future distribution to the grantor. Similarly, the interest of a contingent income beneficiary is adverse to a return of corpus to the

grantor before the termination of his interest but not to a return of corpus after the termination of his interest.

(d) The interest of a remainderman is adverse to the exercise of any power over the corpus of a trust, but not to the exercise of a power over any income interest preceding his remainder. For example, if the grantor creates a trust which provides for income to be distributed to A for 10 years and then for the corpus to go to X if he is then living, a power exercisable by X to revest corpus in the grantor is a power exercisable by an adverse party; however, a power exercisable by X to distribute part or all of the ordinary income to the grantor may be a power exercisable by a nonadverse party (which would cause the ordinary income to be taxed to the grantor).

§ 1.672(b)-1 Nonadverse party.

A *nonadverse party* is any person who is not an adverse party.

§ 1.672(c)-1 Related or subordinate party.

Section 672(c) defines the term "related or subordinate party". The term, as used in sections 674(c) and 675(3), means any nonadverse party who is the grantor's spouse if living with the grantor; the grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; or a subordinate employee of a corporation in which the grantor is an executive. For purposes of sections 674(c) and 675(3), these persons are presumed to be subservient to the grantor in respect of the exercise or nonexercise of the powers conferred on them unless shown not to be subservient by a preponderance of the evidence.

§ 1.672(d)-1 Power subject to condition precedent.

Section 672(d) provides that a person is considered to have a power described in subpart E (section 671 and following), part I, subchapter J, chapter 1 of the Code, even though the exercise of the power is subject to a precedent giving of notice or takes effect only